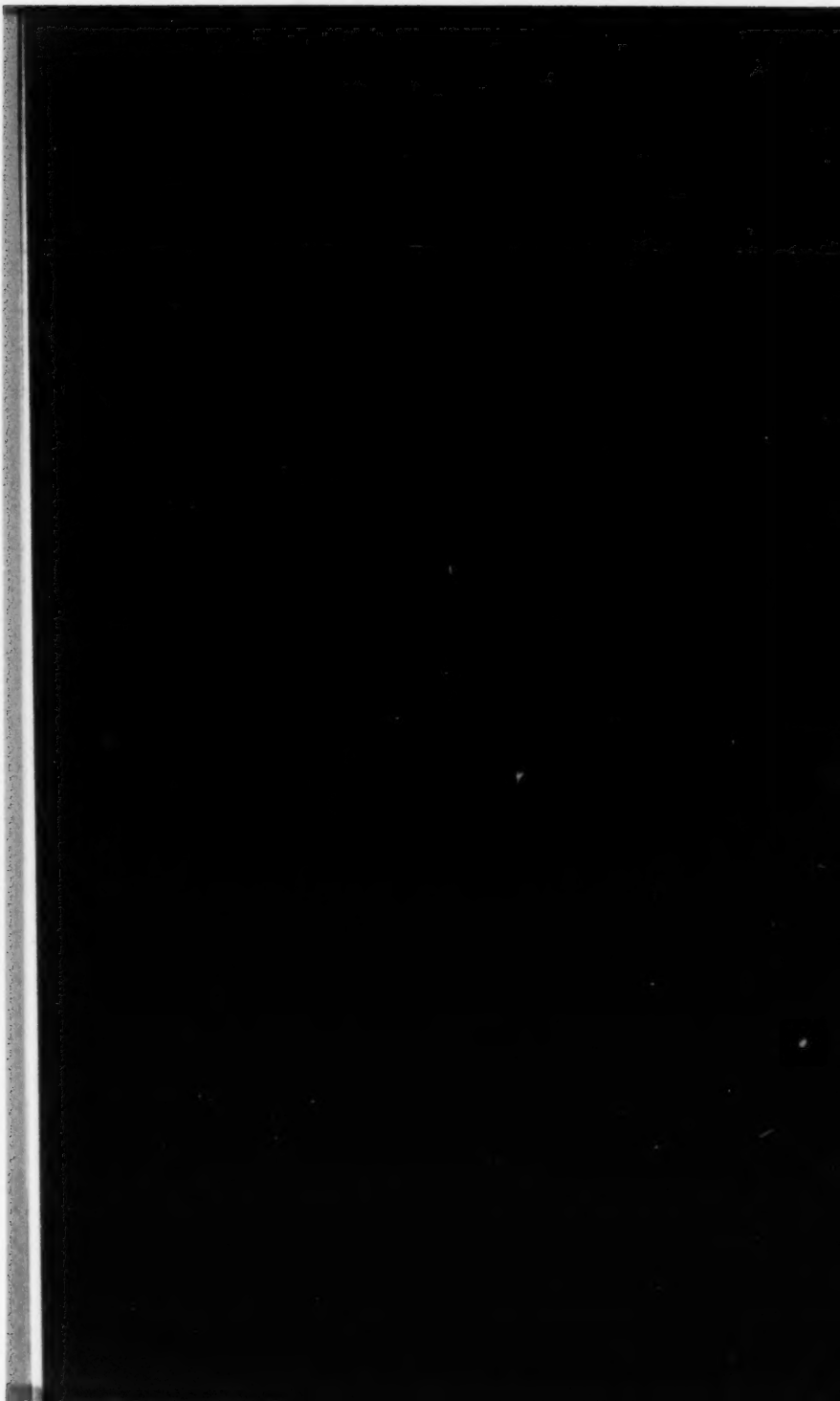

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF AMICI CURIAE.

This brief is submitted on behalf of Brown Shoe Company, Inc., pursuant to the accompanying written consent of the respective parties.

Statement.

The Commissioner of Internal Revenue has determined deficiencies in income tax for the year 1935 against the petitioner. The basis for his determination is that petitioner, prior to the year 1935, re-acquired certain shares of its capital stock, which shares were not cancelled, but remained in its treasury. During the year 1935, the peti-

tioner reissued certain of its treasury stock in exchange for a small remaining balance of publicly held stock of a subsidiary company and, also, during the same year, petitioner sold certain shares of its treasury stock to certain of its officers in accordance with an option given them in 1933. The Commissioner determined that the difference between the re-acquisition price of the stock sold or exchanged in 1935 and the price at which it was so sold or exchanged represented taxable gain to petitioner.

The United States Board of Tax Appeals (now The Tax Court of the United States) in an unreported memorandum opinion dated May 19, 1941, determined that petitioner had realized no taxable gain from the purchase and resale of its capital stock. The United States Circuit Court of Appeals for the Second Circuit on July 16, 1942 (130 F. (2d) 145), reversed the decision of the Board of Tax Appeals and petitioner seeks a review of that decision.

The questions in this litigation which particularly concern the *amici curiae* are:

> 1. Does Article 22(a)-16, Regulations 86, involved herein, correctly interpret Section 22(a) of the Revenue Act of 1934?
>
> 2. If it does, was the petitioner dealing in its own shares as it would in the shares of another corporation?

Upon the answer to these two questions depends the determination of whether petitioner realized taxable gain in selling to its officers under options previously given to them, shares of its treasury stock.

Reasons for Allowance of the Writ.

1. Numerous cases involving the questions presented here are now pending in several Federal Courts.

Brown Shoe Company, Inc., on whose behalf this brief is filed, is petitioner in the case of *Brown Shoe Company, Inc.* v. *Commissioner,* now pending before the United States Circuit Court of Appeals for the Eighth Circuit. Briefs have already been filed and oral argument is to be heard before the court on November 10, 1942. That case involves a determination of whether under Article 22(a)-16, Regulations 94, the provisions of which are substantially similar to the provisions of Article 22(a)-16, Regulations 86, involved herein, and Section 22(a) of the Revenue Act of 1936, which was a re-enactment of the same provisions of the 1934 Act, the taxpayer realized taxable gain in the sale of treasury stock to its president and certain "key employees".

There are also pending before the United States Circuit Court of Appeals for the Eighth Circuit, the cross-petitions of *Helvering* v. *Edison Bros. Stores, Inc.* and *Edison Bros. Stores, Inc.*, v. *Helvering,* involving the same sections of the 1934 and 1936 Revenue Acts and the same articles of the Regulations 86 and 94 promulgated thereunder. Oral argument on these cross-petitions has been set for November 10, 1942, just preceding oral argument in the case of *Brown Shoe Co., Inc.* v. *Commissioner.*

An appeal has also been taken from a decision of the United States District Court, Western Division of the Western District of Missouri, in *Stern Bros. & Co., Inc.* v. *United States,* 45 Fed. Supp. 583 (July 6, 1942), to the United States Court of Appeals for the Eighth Circuit. That case, too, arises under Section 22(a) of the Revenue Act of 1936 and involves the resale to officers and employees of treasury stock previously acquired.

There are also cases now pending before the United States Court of Claims involving this same question.

2. The Supreme Court of the United States specifically left undetermined the question involved herein when it

decided in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 308 U. S. 110, 116, that a 1934 amendment to Article 66 of Treasury Regulation 74, promulgated under the Act of 1928, which was intended to apply retroactively the same provisions as are contained in Article 22(a)-16 of Regulations 86, here involved, did not correctly interpret Section 22(a) of the 1928 Act.

The numerous Judges called upon to decide the above pending cases and several recently decided cases have by no means been in accord either in their results reached or their analyses of the problems left undecided by the *Reynolds Tobacco Co.* case, *supra.* Thus the decision in the instant case by the Second Circuit Court of Appeals not only reversed the Board of Tax Appeals (now the Tax Court of the United States) in this case, but was decided over the vigorous dissent of Judge Learned Hand, and reversed the prior rule of this same Circuit Court which had been announced in the case of *E. R. Squibb & Sons* v. *Helvering,* 98 F. (2d) 69, Mod. 102 F. (2d) 681. The confusion existing in the Second Circuit is duplicated in other courts and in the Board of Tax Appeals. Thus in *Brown Shoe Company, Inc.* v. *Commissioner,* 45 B. T. A. 212, the Board reversed its earlier decision in *National Home Owners Service Corp.* v. *Commissioner,* 39 B. T. A. 753. The Eighth Circuit Court of Appeals, which now has the duty of reviewing that decision against the taxpayer, also has pending a decision in favor of the taxpayer on this same question (*Stern Bros. & Co., Inc.* v. *U. S., supra*). It is respectfully submitted that the Supreme Court should certainly take jurisdiction to terminate the hopeless confusion in which the lower courts now find themselves.

3. The facts to which the Commissioner herein seeks to apply the regulations typify situations which are recurrent in modern corporate enterprise. This case involves transfer of treasury stock to certain officers of petitioner. It is

well known that the custom of encouraging employees and officers to purchase stock of the companies for which they are working is a device for maintaining the loyalty and cooperation of employees which has become more and more widespread in recent years. The instant case also involves transfer of treasury stock to a controlled corporation in return for its stock. The increasing amount of litigation and remedial legislation centering around the scope of tax-free inter-corporate reorganizations and exchanges of stock is too well known to require citation of specific instances.

Both of these types of factual situations are becoming more and more frequent, and this Court should take jurisdiction to settle the conflicts in the lower courts now harassing both taxpayers and government in their search for a tax policy upon which they can safely rely.

4. The decision of the Circuit Court of Appeals in the instant case apparently laid down a rule which will seriously affect and confuse collateral rules of tax law. The majority of the court below based their interpretation of the regulations as applied to the facts herein upon the principle that taxation will follow use of treasury stock "as an ordinary asset". The question of the extent to which shares of a corporation's own stock may be deemed to be an ordinary asset is a typical one. In *Eisner* v. *Macomber,* 252 U. S. 189, this Court held that the distribution of stock of a corporation could not be considered a distribution of an asset, under certain circumstances. (Compare: *Koshland* v. *Helvering,* 298 U. S. 441, wherein this Court held the treasury regulations to have misconstrued the law as enunciated in *Eisner* v. *Macomber.*) Recently the question of whether or not a dividend declared and payable in treasury stock may be considered the distribution of an asset within the scope of the income tax law has arisen, and the Board of Tax Appeals has twice ruled that such a dividend does not constitute taxable income. *Bruckheimer* v. *Commis-*

sioner, 46 B. T. A. 234; *Travis* v. *Commissioner,* (unreported officially, Prentice-Hall B. T. A. Memorandum Service, 1942, Para. 42,386). The decision of the majority of the Circuit Court of Appeals in the instant case is opposed in principle to this rule. This additional conflict of principles affords a further reason for this Court to take jurisdiction in the case at bar.

ARGUMENT.

1. Article 22(a)-16, Regulations 86 does not correctly interpret Section 22(a) of the Revenue Act of 1934.

Prior to May 2, 1934, Treasury regulations promulgated under the various Revenue Acts, commencing at least with those issued under the 1918 Act, uniformly provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock". During that same period, beginning at least with the 1918 Act and extending through the Revenue Acts of 1921, 1924, 1926, 1928 and 1932, the statutory provisions of which the regulations were interpretative, were reenacted without any material change. The Supreme Court of the United States in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 308 U. S. 110, held that the repeated reenactment of the statutory provisions, while the regulations interpretative thereof remained unchanged, gave to such regulations the force of law. Section 22(a) had, therefore, gained a settled meaning which was applied by the Supreme Court in that case.

The change made in the regulations took place on May 2, 1934, before which time both the House of Representatives and the Senate had acted upon the 1934 Revenue Act, in which Section 22(a) was reenacted without change. The Conference Report was adopted by both the Senate and the House but one day after the change in regulations, and it cannot be said, even if the Commissioner of Internal

Revenue had the power, that he by that change in regulations brought about a change in the meaning of "gross income", as it had been used in all of the Revenue Acts up to and including the 1932 Act.

Furthermore, the uniform provision of the regulations, that a corporation does not realize gain or loss from the purchase or sale of its own stock, is in accordance with the true nature of the transaction, and the change in regulations seeks to tax as income that which by its nature does not constitute income.

A corporation, when it reacquires shares in itself, obtains nothing that can be called a true asset. A corporation cannot own an interest in itself. The fact that it may carry that stock as treasury stock does not make of the stock a true asset. When the corporation sells shares in itself, it makes no difference whether it sells treasury stock or a new issue. It is simply acquiring new assets *at that time* and giving the vendor an interest in itself along with its other stockholders. It is a capital transaction whether or not it sells treasury stock or a new issue, and no income has been realized in either event. The change in regulations, therefore, attempts to tax as income that which is not income.

2. Petitioner's sale of treasury stock to its officers did not constitute dealing in its own shares as it might in the shares of another corporation.

It is obvious that what petitioner was doing was to give its officers an interest in their corporation. If a "similar" transaction were carried out in the shares of another corporation, its effect would necessarily be entirely different. The pride of proprietorship, which an officer has in his own corporation when he owns shares of stock in that corporation, could never be present when he is sold the shares of stock in some strange corporation. What they acquired

was part of or interest in the proprietorship of the petitioner, and that could not have been acquired through the sale of shares of another corporation.

Conclusion.

It is submitted that, for the reasons pointed out, the decision of the court below presents Federal questions of general importance, which have not been decided by this Court. Those questions were left undetermined in the prior decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co., supra,* and those questions are involved in numerous cases now pending before Federal Courts, including the United States Court of Appeals for the Eighth Circuit and the United States Court of Claims, and those questions should be decided by this Court.

The Petition for a Writ of Certiorari should be granted.

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